Interconnectedness of the Economy and Society:

A Theoretical Examination of the Limits of Knowledge

Brian Z. Tamanaha

(Draft)

Several academic disciplines in the last three decades have converged on the view that to understand an economy one must pay attention to surrounding cultural, social, political, and legal institutions and ideas. New Institutional Economics (NIE) promotes the idea that economic actors are enabled and constrained by informal and formal institutions that structure economic activities. Economic Sociology (ES) is united by the proposition that the economy is embedded in social relations. Economic Geography, Economic Anthropology, and Economic Sociology of Law also take this perspective,¹ as well as work in law and development.² A great deal separates these fields from one another, and divides scholars within each, but the basic overarching lens is the same: a holistic vision of the economy interconnected with its social surroundings.

They also share a common target: the Homo Economicus model. In Institutions, Institutional Change, and Economic Performance, which kick-started the spectacular rise of NIE, Douglass North argued neoclassical economics fails to recognize that informal and formal institutions shape and constrain available opportunities, and that people make decisions with limited information through mental constructs that can be faulty.³ This combination helps explain the entrenchment of inefficient institutions which reduce economic development over

time, locked in place through path dependence and resistance to change by stakeholders who procure benefits from existing arrangements. North’s aim was not to debunk neoclassical economics but to render it more realistic. Economic Sociology launched a more fundamental critique, challenging the model of an autonomous market, which construes all political and cultural influences as interferences, arguing instead that “economic transactions are enmeshed in a thick net of personal [and political] relationships that explains order in economic life.”

ES scholars bring out personal and social dimensions that course through and undergird economic transactions, including religious and cultural values, trust, reciprocity, cooperation, social networks, and access to information and resources. These factors undermine the neoclassical image of purely self-interested rational actors exchanging good and services on an open market.

This is not solely a matter of academic interest. The World Bank and other development organization in the past two decades have expended substantial sums on efforts to build “good governance” and the “rule of law” on the theory that a successful economy requires sound institutions. A best-selling recent book on development titles a key chapter, “Why Nations Fail Today: Institutions, Institutions, Institutions.” The conditions necessary for sustained economic success, the authors assert, are supportive social, legal and political institutions.

Beneath surface agreement about the interconnectedness of the economy and surroundings, these disciplines are marked by disagreement and fuzziness on how this should be conceptualized. Mark Granovetter, who brought “embeddedness” of the economy to the fore in

---

a seminal article three decades ago, later distanced himself from the term as meaningless. NIE has long struggled with how to define institutions. Nearly three decades ago Elinor Ostrom acknowledged the “embarrassing” lack of consensus over the meaning of “institutions;” and despite many efforts since, leading theorist Masahiko Aoki recently acknowledged, “there does not seem to be an agreement” on “what institutions are.”

This essay explores why conceptualization has proven so difficult. Delving into this recalcitrant puzzle provides information about the interconnectedness of the economy and society, as well as insights that bear on the assumptions and objectives of scholars who study these relationships. My theoretical discussion centers on NIE because it has valiantly wrestled with conceptual issues and it has the most influence on policy makers and the most prestige (led by Nobel Prize winners Douglas North and Elinor Ostrom). I explain why the debate over what institutions are cannot be resolved, but also that this inability does not matter. More critically, I show that owing to the nature of social behavior, NIE scholars must trim their ambitions, particularly on policy prescriptions. Finally, I outline an alternative framework useful in development contexts.

THE RISE OF THE TECHNO WIDGET

Before taking up theoretical issues, a simple scenario in several parts will help illustrate what scholars mean by the interconnectedness of economic activity.

---

Thirty-five years ago a young farming couple in rural China was ready to make a major life change. Their village was slowly dying as young people moved to cities to find work, and the area had endured an unrelenting drought that lowered yield on collective farms. The couple wanted a son, but already had a daughter, and the government’s one-child policy stood in their way. Thus they decided to leave for America, but the trip would be costly. They scratched together some savings by selling extra produce from a small personal plot to a traveling peddler who sold goods in the city; other villagers contributed what little they could, and an uncle in New York City sent money to help. That was not enough, so to make up the difference they committed to labor for several years at the disposal of a criminal organization that transported and secreted them into the US. 11 Their daughter remained behind in the care of her grandmother.

Settling in a Chinese community in Queens, New York, they took a room in an apartment owned by another Chinese immigrant. They worked long hours at multiple jobs, primarily at restaurants and garment factories, earning below minimum wage. 12 A son was born to them. They satisfied their labor obligation to the gang and sent money back to the villagers who helped them; after several years they had enough to bring over their daughter and her grandmother. Speaking only Chinese, without bank accounts or any official documents, they worked off the books for several years. This changed after an immigration reform act passed in 1986 granted amnesty to illegal aliens; assisted by others in the community, they filed papers and acquired legal residence.

Over time, they came up with enough savings to join a small rotating fund club—wherein each member contributes a set amount at regular intervals, with the pooled amount going to one person to start a business, each member getting a turn at the full sum. 13 Only trustworthy people vouched for by an existing member would be admitted to the group. This is the best way for members to obtain a substantial amount because banks would not loan to people without assets or to people lacking legal status. When their turn came, the couple purchased equipment and a van to start a business cleaning commercial offices after the close of work; they did the labor themselves, assisted by their daughter when she was old enough. Clients were obtained through community contacts. 14 Disputes with clients occasionally occurred, which they resolved through compromise, directly or with the assistance of a respected member of the community.

Variations of this story have played out innumerable times around the world. Economic transactions take place through social relationships and obligations. No official legal contracts for labor, loans, or housing were entered into, yet it all functioned smoothly. Relationships of trust and reciprocity (family and villagers) and the presence of potential sanctions (personal guilt, ostracism by family and villagers, harm by criminal organization), underwritten by a cultural sense of honor and mutual support, allowed the couple to obtain substantial loans that everyone involved felt secure would be repaid. Law had an influence by affecting their options (one child policy, illegal status) and by structuring aspects of society in which they lived and worked (traffic laws, rules specifying trash disposal in the buildings they cleaned, etc.). And law would have intruded, for example, had they gotten into a car accident and been sued for injuries. But otherwise they carried on with scant direct contact with official law. Throughout human history, people have carried out their affairs—bought and sold property, engaged in commerce, procured food, shelter, and amenities—within the family and community through social norms and relationships. This still goes on today in many places around the world.

Their son, Tinkerer, was obsessed with playing video games and taking apart computers. His parents wanted him to become a doctor, but he hated school. He took an engineering course at a local community college but soon dropped out, preferring instead to spend hours in his room fooling with electronic devices, occasionally helping his parents on cleaning jobs. After a few years had passed, Tinkerer invented a techno widget that he dreamed would be the next big thing. He got in touch with an old high school friend, Entrepreneur, who just graduated with a business degree, asking him for help. They downloaded from LegalZoom legal forms to create a corporation, filing in New York State, naming the company Techno Widget Corp. (TWC). They adopted a standard set of Bylaws for TWC (which they found online), specifying voting rights, the number of Directors and their powers and duties, and other matters. Then, on behalf of TWC, they filed a patent request for the techno widget with the United States Patent and Trademark Office, which was granted. Indulging their son, Tinkerer’s parents paid all the fees for purchasing and filing the forms, although they believed nothing would come of it. A hundred shares of a single class were issued in all—80 assigned to Tinkerer, 5 to his

parents (out of gratitude and affection for their support over the years), and 15 to Entrepreneur.

To everyone’s surprise, things moved rapidly thereafter. Entrepreneur got in touch with a rich classmate from college, who put him in touch with family friends who knew people who ran an investment fund. After reviewing the device and patent, seeing its promise, they agreed to a make a large investment in exchange for half of Tinkerer’s shares. The investors brought in experienced managers. Tinkerer assumed the position of head engineer, continuing to work on the device; Entrepreneur became a salaried officer of TWC.

Again let us pause, this time to appreciate a remarkable happening: a new (legal) person has been brought to life. TWC has a genuine existence apart from the people whose activities gave rise to it (incorporators), who own it (shareholders), who work for it (employees), who oversee it (Board of Directors), and who run it (managers). It is constituted by and through law. Its purpose and skeletal organization, its basic characteristics and functions, are specified legally through its articles of incorporation and bylaws, along with requirements imposed by New York corporations law. Particular powers are attached to specified roles, filled by people who make decisions on its behalf: when these people act in their official capacities, the corporation (it) acts. Like flesh-and-blood people, TWC has property rights, contract rights, and speech rights (at least in the US), and takes purposeful actions in the world. Though it cannot breathe, feel pain, or walk down the street, it undoubtedly exists.

TWC swiftly ramped up production and sales activities. It hired office staff, line workers, sales people, etc., and rented and refurbished a warehouse, bought equipment, entered contracts with suppliers for subparts, and began to manufacture the techno widget. Salespeople met with contacts in the technology media to create advance buzz about the product. Retailers agree to carry it. Sales exploded when techno widget hit the market. Production soon quadrupled, then quadrupled again, again, and again; additional production factories were opened; more supplies of raw material were required; many more employees were hired.

To fill the Personnel Director position, Entrepreneur hired a woman he had met when he interned during college at the company she worked for. Because her former company followed affirmative action policies in hiring and had established an employee grievance
system, the Personnel Director implemented both at TWC, believing they were good programs and would protect them legally from being sued (a mistaken assumption\textsuperscript{16}). Much of what she set up at TWC replicated policies and practices from her previous workplace, modifying a few to better fit the circumstances.

There were growing pains. A supplier was dropped after producing too many defective parts (prompting a threat to sue, which was resolved). TWC shifted to German manufacturers of parts to improve reliability and increase its supply, using a corporate law firm that specialized in transnational transactions to formalize the supply agreements. A number of employees filed grievances about working conditions, and several people were injured in accidents at work. At one facility, a union organizer began efforts to start a union among the unskilled workers.

Overall things were going smoothly. Tinkerer and the investors (and the Board they effectively controlled) decided to take the company public. It was a highly successful issuance, achieving a total share value of $1 billion at the end of the first day. Tinkerer’s parents cried together that night in wonderment about the extraordinary distance they had traveled in their lives.

Law now affects all sorts of matters. A host of securities laws apply to TWC as a publicly traded corporation, including notice and transparency requirements, accounting requirements, laws restricting trading on insider knowledge, laws governing the issuance of corporate bonds to raise money, and much more. Antitrust laws restrict efforts to suppress competition in the market. Laws against deceptive advertising apply to its marketing and sales efforts. Health and safety laws apply to workplaces. Anti-discrimination laws apply to its hiring practices. Employment laws address its relations with employees, from setting a minimum wage, to requiring certain employee benefits, to providing protections for whistleblowers. Labor laws apply to its dealings with union-related activities. Environmental laws affect their handling and disposal of materials used in manufacturing. Building codes, fire codes, and zoning laws apply to their facilities; tax laws require payments, as well as affect how it reports and structures its activities (seeking to minimize its tax burden). And on top of all that, ordinary property, torts,

and contract regimes apply in connection with its own affairs, its relations with workers, and its interaction with others. These various legal requirements take different forms: legislation, administrative regulations, ordinances, executive orders, administrative findings or rulings, and judicial decisions. They are issued by federal, state, and municipal authorities; some with attendant criminal penalties, or civil penalties, or both; some enforced by government actors, or by private actors, or by both.

This slew of laws and regulations appears to cast a comprehensive net of regulation over TWC, but it is critical to keep in mind that these laws and regulations are words on paper. What real effects they might have on the conduct of corporate actors depends on many factors: actual knowledge of the restrictions, incentives to comply or not comply, monitoring and enforcement capacity by government officials, a genuine commitment to enforce the rules,\(^\text{17}\) and so on.

Individual and social influences continue to pervasively affect the corporation, for \textit{it} operates only through the conduct of people acting on its behalf. People working in the company are pursuing their desire for remuneration and advancement as they fill their designated roles responsibilities, and their actions are shaped by ideas and beliefs they have picked up. Social networks of various kinds shape the constitution and operation of TWC.\(^\text{18}\) Different individuals with different networks would have resulted in differences in the doings of TWC. Had Tinkerer direct access to elite social connections (not resorting to a high school buddy), the original


arrangement would not have been the same, and among other differences he might have retained more shares for himself and secured greater control. A personnel director with different knowledge and prior work experiences would have implemented different policies and hired a different set of employees.

Within 5 years, TWC was diversifying its products and selling around the world, feeling pressure from competitors of techno widget coming on to the market. After the original investors and Entrepreneur sold chunks of their shares, and a large volume of additional voting stocks was issued, reducing the percentage held by Tinkerer, top corporate officers began to effectively control the corporation, though they still answered to the Board.

TWC management decided to phase out production facilities in the US and move to lower cost countries abroad. First it explored Vietnam and Cambodia, but had concerns about problematic infrastructure (power, communication, and transportation), insufficient pools of educated workers, unreliable government policies and respect for property rights, and rampant corruption. Tinkerer persistently lobbied the CEO that China would be a better location, saying his connections could get more favorable arrangements than most multinationals obtain. (Their rags-to-riches tale had made Tinkerer and his parents famous in China.) Tinkerer sent Chinese contacts to approach multiple government officials (bearing small gifts and promises of benefits) to ease the way.

After extended negotiations with government officials, TWC entered an agreement to open several large facilities in special economic zones as a joint venture with a government owned electronics manufacturer to build techno widgets for export.\(^{19}\) TWC management was attracted by reduced taxes and export tariffs, limited workplace and employment regulations, minimal environmental restrictions, low wages, an abundant supply of educated and disciplined workers, and an agreement that disputes would not be heard in Chinese courts but by independent arbitrators.\(^{20}\) TWC hoped to later sell to Chinese consumers.

Its stock price rose sharply when TWC announced its plan to close US production facilities. The news also incited a public backlash. Politicians from states with production facilities bemoaned the loss of jobs, questioning the patriotism of the company. Labor leaders protested the company’s anti-union stance. Online petitions to boycott the techno widget collected half-a-million signatures in a week. Legislatures in several states with facilities met in special session to vote tax breaks to entice the company to stay.\(^{21}\) Aided by sympathetic contacts in the media, international labor

\(^{20}\) For a discussion of independent arbitrators to reassure business, see Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It* (2007) 153-54.
NGOs incited a burst of renewed publicity about low pay and deplorable working conditions in factories in China. To dampen the public backlash, TWC announced that it might keep a couple of US factories open. It also promised that its Chinese factories would voluntarily comply with model Corporate Codes of Conduct on health and safety conditions for workers and for environmental protection.

Aside from again showing various social influences on economic activity, one revealing aspect of this scenario is that self-imposed codes of corporate conduct and independent arbitrators to hear contract disputes, both outside the official state legal system, can provide effective quasi-legal mechanisms in modern commerce. Another revealing aspect of this scenario is the ways in which governments are involved in the economic arena. One obvious way is through raising or lowering regulations and taxes (or providing subsidies) that affect costs for economic actors.

A less obvious way is that governments themselves are economic actors. Assume for the moment, when viewed sociologically (elaborated on later), there is little to distinguish corporations from governments as bureaucratic organizations—as hierarchies of purpose-oriented complexes of coordinated actions that require and expend resources. Furthermore, assume that governments resort to multiple means to acquire resources (or revenues) to run its operation. It can directly invest in stocks and bond, own and exploit natural resources, and produce and sell goods and services in the market—as China does. Another means is that governments can “sell” services like policing, dispute resolution, and defense from external invaders, and build facilities like roads. These are its products. People “buy” these products from the government, not voluntarily in markets, but through mandatory exaction (called “taxes”). (From this perspective, when governments offer tax breaks as incentives to corporations, they are reducing the price they charge for services to beneficiary corporations
while others continue to pay.) This perspective of government as economic actors may seem counter-intuitive, but a later look at organizations will make it more plausible.

Labor unrest was becoming more pronounced in China, with tens of thousands of factory workers striking.22 Although official Chinese news agencies did not report about the strikes, international labor organizations help get word out through other outlets. In the US, meanwhile, an avowedly pro-business president from the Republican Party was elected, helped by substantial campaign funding from corporations and trade associations. Congress was deadlocked, but he advanced his agenda by appointing former industry lobbyists and lawyers to head major administrative agencies; they filled upper staff positions with people who had worked in corporations or for trade associations in the regulated industries.23 These new agency officials then implemented major regulatory changes—including some of the very provisions they had previously lobbied for—on matters from pollution control to employment regulations, in an effort to reduce costs for American corporations. Liberal groups challenged many of these changes in federal court, achieving mixed success: losing most cases heard by judges appointing by Republican presidents, while winning appeals decided by Democratic-appointed judges.24

In view of the labor unrest in China, enhanced tax breaks in the US, reductions in cost from wage concessions (wring from unions in response to the threat to leave), and loosened regulatory requirements, TWC slowed its planned shift to China, proceeding with half the factories originally planned. TWC’s Chinese contacts felt betrayed by the slowdown, and would no longer trust the word of its corporate officers. They quietly vowed that TWC would not get access to the Chinese consumer market.

Through it all, techno widget sales remained robust, with enthusiasts eagerly anticipating the forthcoming techno widget II.

Among various social and political influences mentioned, this final episode opens up yet another angle, showing the penetration by economic and ideological influences on the legal system and polity. Regulatory power is premised on expertise, judging on unbiased rule application, and the polity on democratic rule, yet political and legal systems are infused in

---

multiple ways by social and economic influences. Output from the polity and legal system cycle back to the economic arena, constituting a loop with mutual influence.

Patched together from common occurrences (though inventions of this magnitude are rare), this scenario reveals a multitude of ways in which economic activity is wrapped into surrounding social and legal factors, and also how legal factors are wrapped into surrounding social and economic factors. Influenced by socially transmitted knowledge and beliefs, people undertake actions in socially structured contexts, filling roles attached to positions, trying to earn enough to meet their desires while operating with motivations that cannot be reduced solely to the maximization of self-interest. This scenario exemplifies the interconnectedness of society in its economic, social, cultural, political, and legal aspects—although it is just a snapshot that leaves out a huge amount, saying little about the dynamics of dysfunctional situations, the impact of religious views, the effect of different types of work cultures in factories, the impact of values and interests of the legal profession, and much more.

When presented in plain terms this situation is easily understandable. Theoretical discussions about institutional influences on economic transactions make things much more complicated.

WHAT ARE “INSTITUTIONS” AND “ORGANIZATIONS”? 

Douglas North offered straightforward definitions of these pivotal terms. “Institutions are the rules of a game in a society or, more formally, are the humanly devised constraints that
shape human interaction.”

“Institutions include any form of constraint that human beings devise to shape human interaction.” As constraints, they structure human interaction, and can be formal (written rules, laws) or informal norms (conventions and other social norms). They can come about through deliberate creation or unplanned evolution, of a combination of both. Organizations, in contrast, are “groups of individuals bound by some common purpose to achieve objectives.”

“Organizations include political bodies (political parties, the Senate, a city council, a regulatory agency), economic bodies (firms, trade unions, family farms, cooperatives), social bodies (churches, clubs, athletic associations), and educational bodies (schools, universities, vocational training centers).”

North posits this “crucial distinction” as the framework for his analysis. Institutions define the rules of the game and organizations are the players. What organizations do is influenced by the institutional framework; in turn, they are agents of change when working within, striving to alter, and getting around the rules to accomplish their objectives. To discern the sources of rapid economic progress or stagnation, North urged, requires close attention to the interaction between organizations and institutions. “Organizations are created with purposive intent in consequence of the opportunity set resulting from the existing set of constraints (institutional ones as well as the traditional ones of economic theory) and in the course of attempts to accomplish their objectives are a major agent of institutional change.”

---

26 Id. 4.
27 Id. 5
28 Id.
29 Id. 4.
30 Id. 5.
The debate over the meaning of these terms has not abated since North set them out. In a subsequent clarification (which perhaps added to the confusion), North acknowledged that, notwithstanding his sharp contrast, “for certain purposes we can consider organizations as institutions,” at least when viewed in terms of their internal structures rather than their macro aspects as an organization. Competing definitions within NIE, Jason Potts writes, “range not only over how institutions function, or how they emerge and change, but extend to seemingly incommensurable definitions of what institutional actually are….In all cases, institutions are of fundamental importance to economic analysis, yet their specific analytical nature remains a point of serious contention.”

An often-cited article by Geoffrey Hodgson, “What are Institutions?,” defines institutions “as systems of established and prevalent social rules that structure social interactions. Language, money, law, systems of weights and measures, table manners, and firms (and other organizations) are thus all institutions.” His examples cover vast range of disparate phenomena.

Human social existence takes place on a background of shared norms which enable communication and coordinate actions. Defining institutions in a way that includes the background pulls in almost all aspects of social life. That’s why language is on his list. By Hodgson’s definition, practices like lawyering or conducting scientific research are institutions, since they consist of socially transmitted bundles of norms, tacit knowledge, habits, and skills,

---

which enable and constrain activities.\textsuperscript{34} Reciprocity is an institution for it is norm governed and structures relationships of exchange. Similarly, every day conversations are institutions, since they are structured by conversational norms—“implicit rules and assumptions that are followed and made by speakers and that listeners assumes speakers follow.”\textsuperscript{35} Widely shared knowledge and beliefs (in so far as they are structured by rules like language) constitute institutions, for they enable and constrain activities and contribute to structured patterns of behavior. Masahiko Aoki observed, “common knowledge in a substantive form of an institution induces a shared belief.”\textsuperscript{36} He calls this the “institution as-cognitive-media view.”\textsuperscript{37} It takes only a small additional step from there to assert that institutions are constituted by shared mental constructs like cognitive schemata or mental models that shape and structure how people perceive the world and engage in social intercourse,\textsuperscript{38} producing patterned conduct.\textsuperscript{39} A concept of institution that ranges from language to a corporation (and innumerable other phenomena) is not very serviceable.

Fuzziness surrounds the term “organization” as well. John Wallis, who collaborated with North on an important book, articulated this conception: “Organizations can be thought of as interlaced bundles of relationships and contracts. Relationships between individuals are


\textsuperscript{36} Masahiko Aoki, “Institutions as Cognitive Media Between Strategic Interactions and Individual Beliefs, 79 > of Economic Behavior and Organizations 20, 26 (2011).

\textsuperscript{37} Id. 25.


sustained by repeated interaction and the existence of rents to both parties.” Some of these agreements are self-enforcing, but most rely on third-party enforcement. Activities of organizations in the pursuit of rents (benefits) for members, he asserts, play an important role in shaping and changing formal and informal rules.

As with institutions, by defining organizations in such loose terms—bundles of relationships and contracts held together by rents—it encompasses disparate situations at various levels and has a tendency toward expansion. Wallis says “the scale of the group could be the whole society,” or smaller groups embedded within societies. Addressing the city of Genoa and the Maghribi traders, Wallis writes, “Both groups could be denoted as organizations, that is, as a specific group of individuals bound by a common set of institutions, beliefs and interests (even though their individual interests could, at times, be at odds within the framework of the organization).” A remarkable range of phenomena count as organizations in his view: “all hunting and gathering bands are adherent organizations, held together by the value of the relationships within the group.” Business corporations are organizations, along with churches, schools, political parties, universities, and social associations of many types. Wallis “defines the state as the organization that organizes other organizations. One type of organizations that states organize are governments.” He does not explain in what sense the “state” consists of relationships and agreements based on rents obtained by contracting parties; nor does he address whether international or transnational systems, like the United Nations or the European Union, are also organizations that organize other organizations (though this would seem to follow). A

41 Id.
42 Id.
43 Id. 54.
44 Id. 59.
45 Id. 60, 50.
concept of organization that ranges from a hunter-gather group, to a corporation, to an entire city, to a state (and innumerable other phenomena) is not very serviceable.

Questions also exist about the connection between institutions and organizations. Institutions are structures, whereas organizations are actors. All institutionalist analysis accepts, writes Jason Potts, that “Institutions compose the economy as markets, organizations and correlated behaviors, but also constitute the economy as the legal/social/political cultural “rules of the game” that define the space of economic opportunity.” Thus, not all institutions are organizations, but it appears that all organizations are institutions, at least when viewed in terms of their internal rule-based construction. Accordingly, hunter gatherer bands and entire cities are institutions and organizations, as well as have institutions and organizations within them.

This is a conceptual quagmire, although NIE scholars appear undaunted. They have presented several reasons for endeavoring to come up with a uniform understanding of institutions and organizations. First, they aspire to build a cumulative body of knowledge centered on economics while incorporating other social sciences, which presumably requires agreement on basic concepts. Elinor Ostrom wrote, “If every social science discipline or subdiscipline uses a different language for key terms and focuses on different levels of explanation as the ‘proper’ way to understand behavior and outcomes, one can understand why discourse may resemble a Tower of Babel rather than a cumulative body of knowledge.”

Second, NIE work involves developing theories about what enhances or inhibits economic development, using rational actor and game theoretic analysis, backed by historical narratives and empirical data. As one NIE scholar put it, “Only if institutions can be measured with a

---

47 See Ostrom, Understanding Institutional Diversity, supra 11.
minimum degree of confidence are empirical statements such as ‘institutions matter for y’
credible. There are many ways of delineating institutions; however, a minimum degree of
agreement on what exactly an institution is must be reached before trying to measure them.”
Third, NIE is avowedly a policy-oriented field—to an extent unusual in the social sciences—in
which scholars hope to make specific recommendations that enhance economic development.
Their ideas about institutions must be transferrable to other contexts, which requires
consistency. Lastly, although NIE scholars do not offer this as a reason, perhaps it contributes to
their motivation that the field is called New Institutional Economics; labeling compels NIE
scholars to get to the bottom of what this term given such prominence means.

WHY THE DIFFICULTY

What adds to the confusion is that “institution” has casual usages as well as technical
usages. “Legal institution” is commonly used by jurists to refer to courts or legislatures or
prosecutor’s offices—to parts of the legal system; legal constructs like property or marriage are
also sometimes included within the phrase, meant as legal creations secured by law. Legal
theorist Underhill Moore described legal institutions as “the happening over and over again of
the same kind of behavior”—group habits in legal contexts with an expectation that existing
treatment will continue.49

Sociologists have theorized extensively about institutions. Talcott Parsons, whose
functionalist theory was dominant in American sociology in the mid-twentieth century, presented

48 Stefan Voight, “How (Not) to Measure Institutions,” MAGKS Paper in Economics, 2-3, at
http://www.econstor.eu/bitstream/10419/30117/1/61137725X.pdf
societies as ordered systems that evolve in connection with technological developments and environmental changes (physical as well as social), made up of functionally differentiated subsystems: cultural patterns, forms of social integration, the economy, and the polity.\textsuperscript{50} Institutions are central in Parsons’ view, “the institutional structure of a social system…is the totality of morally sanctioned statuses and roles which regulate the relations of persons to one another through ‘locating’ them in the structure and defining legitimate expectations of their attitude and behavior.”\textsuperscript{51} Another prominent social theorist, Anthony Giddens, identified institutions as patterns of action—via interlinked social practices—which endure over time and space constructed by knowledgeable actors drawing on rules and resources in particular contexts of action. “The most important aspects of structure are rules and resources recursively involved in institutions. Institutions by definition are the more enduring features of social life.”\textsuperscript{52} Among sociologists generally, institutions are seen as “socially constructed” features of the social landscape within which people conduct their daily activities, solid and constraining, yet subject to change when ideas and repeated behaviors giving rise to institution change.\textsuperscript{53}

Philosopher John Searle has developed a sophisticated account of the ontology of social institutions. The crucial feature of institutions, he writes, is that through collective acceptance certain specific functions are attached to certain statuses which an object or person exercises by virtue of occupying the designated status.\textsuperscript{54} Accordingly, Barak Obama took on functions and powers of the presidency when he was sworn in, and a dollar bill counts as money because it is

\textsuperscript{50} See Talcott Parsons, Societies: Evolutionary and Comparative Perspectives (Englewood Cliffs, N.J.: Prentiss Hall 1966).
\textsuperscript{54} See John R. Searle, “What is an Institution?,” 1 Journal of Institutional Economics 1,7 (2005)
collectively treated as a unit of exchange. “Status functions are the glue that holds human societies together. Think not only of money, property, government, and marriage, but also of football games, national elections, cocktail parties, universities, corporations, friendships, tenure, summer vacations, legal actions, newspapers, and industrial strikes.”

They have a common structure: constitutive rules (distinct from purely regulative rules) which specify that X counts as Y in context C (X refers to features of an object or person, Y is the assigned status with attendant functions, C specifies when they attach). Institutions create special powers for people “marked by such terms as: rights, duties, obligations, authorizations, permissions, empowerments, requirements, and certifications.” Searle clarifies that practices are not institutions, by his account, because they consist of regulative not constitutive rules and do not involve status functions; so the National Science Foundation is an institution but the rules of scientific method or research practices are not.

While Moore, Parsons, Giddens, and Searle all describe institutions in terms of stable norm-based patterns of action, each has a different take on what they are and what they do. Moore’s account was rudimentary; Giddens rejected Parsons’ functionalist-subsystems take on institutions; Searle rejected practices, which were central to Giddens.

Thus NIE scholars are not alone in lacking agreement on the meaning of institutions. Two factors explain why conceptual agreement is elusive: 1) the nature of the social world, and 2) how theorists and investigators study the social world.

---

55 Id. 9.
56 Id. 7-10.
57 Id. 10.
58 Searle emphasizes that constitutive rules are particular types which, unlike regulative rules, “not only regulate but rather constitute the very behavior they regulate.” Id. 9. Searle uses this to distinguish institutions from practices, which do not count as institutions (in his sense) because they involve regulative rules. Id. 19.
Social life is a continuous, undifferentiated flow of actions across time and space—everything blending in an agglomeration of innumerable, constantly occurring, intentional and unintentional actions and intercourse. No part of this stands still or can be isolated. Behind all social interaction is language, tied to signs and symbols, tied to cognitive schemata, heuristics, and mental models, tied to interpretative schemes and social typifications (formulae for everyday encounters), tied to ideologies, tied to concepts and ideas, tied to knowledge and beliefs, tied to values, tied to language. Social norms shade into social rules, which shade into customs, which shade into conventions, which shade into habits, which shade into social norms. It can be analytically sliced up in myriad different ways.

Efforts to delineate the elements of social life and how they interact thus depend crucially on the purposes of a given theorist or group of theorists. There are differences of perspective among NIE scholars as well as others who emphasize institutions. Everyone might agree that actors, structure, and culture play key roles in social action situations, but there is no agreement on how characterize each, or on their interrelations, or on their relative significance in shaping outcomes.

Similar unresolved disputes exist in other fields that study social phenomena. Anthropologists have never agreed on how culture should be conceptualized—a mid-century study tallying 164 different meanings of “culture” used by anthropologists. Legal theorists have debated how to define law for centuries with no agreement in sight. As legal philosopher


H.L.A. Hart remarked, “Few questions concerning human society have been asked with such persistence and answered by serious thinkers in so many diverse, strange, and even paradoxical ways as the question ‘What is law?’”

There is no single true or scientifically correct concept of “culture,” “law,” “institution,” or of the many other terms used in social theory and the social sciences. These terms refer to social phenomena which do not have pre-set boundaries or delimitations. Concepts applied to examine these phenomena are analytical constructs, conceptualized in different ways because inquirers have different assumptions and objectives. Certain NIE scholars (like North) present institutions as exogenous constraints while others (like Aoki) construe them as endogenous rules because they wish to highlight different aspects in their analysis. A single theorist can change positions without contradiction by shifting the frame: North can insist on drawing a sharp distinction between organizations and institutions for one purpose, yet accept that organizations are institutions for other purposes.

In open scientific inquiry—with no authority dictating a technical meaning binding on all—NIE scholars will not reach agreement on what institutions are no matter how hard they try. The good news is that, although agreement is not possible, it is also not necessary. What matters are the factors that influence economic activities. It is irrelevant whether they count as “institutions” or not. (In the techno widget scenario, for example, one can study the relationships and norms that bind revolving credit groups without saying whether they are “institutions.”)

---

Framing the question at the most abstract level, “What are institutions?,” produces over-inclusive answers, bringing in aspects like language and the entire range of social rules.65

Economists who emphasize the influence of social factors on economic activities have not yet realized the price they must pay for their more sophisticated and realistic understanding. The messy, interconnected social world will not yield to their desire to see and measure it all.

MEASURING CULTURE—CHANGING CULTURE

Economic and legal institutions, NIE scholar Oliver Williamson observed, operate within a more fundamental “social embeddedness level. This is where the norms, customs, mores, traditions, etc. are located.”66 North explained:

It is the admixture of formal rules, informal norms, and enforcement characteristics that shapes economic performance. While the rules may be changed overnight, the informal norms usually change only gradually. Since it is the norms that provide “legitimacy” to a set of rules, revolutionary change is never as revolutionary as its supporters desire, and performance will be different than anticipated. And economies that adopt the formal rules of another economy will have very different performance characteristics than the first economy because of different norms and enforcement.67

North’s final sentence was well known in the 1960s and 1970s among legal anthropologists and law and development scholars. “In view of the recognition of the law’s dependence upon the rest of the culture in which it exists,” wrote Leopold Pospisil, “it amounts almost to folly to think that a legal system of one nation can be easily transplanted into another

65 See e.g. Ostrom, Understanding Institutional Diversity, supra 137-215.
culture and applied to another society.” Robert Seidman elaborated, “In acting, individuals take some account of the constraints and incentives offered by the law. They also take into account a host of non-legal factors. A particular law in two places with different social, political, economic and other circumstances can therefore only by coincidence induce similar behavior in both places.” Lawrence Friedman coined the phrase “legal culture”—views about law circulating within the society—to help explain why legal transplantation rarely worked as intended. “It is perfectly possible, then, for identical structures and to perform very different functions….The legal culture provides fuel for the motor of justice; social values and attitudes fill in the missing elements need to explain uses, nonuses, misuses, and abuses of legal process and the legal system.” Similarly, political scientists at the time identified poor “political cultures” as the explanation for the failure of political institutions to operate properly in developing societies.

To get a sense of how mores, customs, norms and traditions affect economic behavior one must look closely at actual settings to see what is happening. The techno widget scenario mentions several examples of social influences that I took from studies. None of these studies attempted to quantify or measure the norms the observed—only to understand and convey how they worked. How does one measure informal norms? The relevant norms must be identified and isolated, tabulated in terms of adherence (how often followed, circumstances of departure), then put on some kind of scale. After that, relations and interaction between these norms, other

---

informal institutions in that arena, the formal legal system, and economic activities, must somehow be traced or observed. Every step raises daunting challenges.

In the past decade NIE scholars have attempted to show links between culture, governance and economic development. The basic approach is to rely on cross-cultural surveys that measure values within societies, and see how they fare in relation to good governance (rule of law, low corruption, democracy) or economic measures. A study by Amir Licht, et. al., for example, looked at a number of cultural dimensions—embeddedness versus autonomy, hierarchy versus egalitarianism, and mastery versus harmony—finding that cultures higher on autonomy and egalitarianism correlate to higher governance measures. Another study, by Guido Tabellini, used surveys that measured trust, sense of individual control over one’s circumstances, respect (positive values), and obedience (negative value); the societies that are higher on the positive values and low on the negative values show higher growth.

Values are tricky to measure—particularly the degree of intensity with which they are held. Surveys, asking people a bunch of questions, are removed from how values play out in actual behavior, when something is at stake and people must evaluate trade-offs and consequences. Owing to the “subjective and imprecise” qualities of surveys and the gap between stated opinions and actual behavior, it is not clear how confident one can be that they accurately measure what they purport to measure. In addition, there are always issues with study design.

---

and consistency across societies, like how questions are formulated and presented, how people from different cultures and levels of education respond to hypotheticals, and whether different age groups, genders, education levels, economic classes, and cultural groups within a society are accounted for separately.

There are other difficulties. It is exceedingly hard to determine whether correlations reflect causation. Furthermore, assuming a causal link, one must also determine in which direction the causal arrow runs: cultural traits to good governance to economic development, or the other way around, or mutually influencing feedback loops.76 Showing a correlation between culture and economic performance does not identify how this effect occurs. As Tabellini acknowledges, the traits associated with higher economic performance might be related to propensity to innovate or take risks, or to work hard, or some other possibility; nor does it tell us whether these cultural traits “influence economic development directly, or indirectly through the functioning of current institutions.”77

Perhaps additional studies, with supreme ingenuity and unlimited funding, can be constructed to tease these out these issues. In addition to the values mentioned above, it is thought that cultures that encourage delayed gratification, thrift, hard work, and investing in education, tend to do better economically than cultures lacking these values. Say researchers can come up with convincing demonstrations showing specific avenues of causation between these traits and economic development. That leaves the separate task of determining how to operationalize this finding for the purposes of application. Since every society is unique in its history and complex mix of informal and formal institutions, no general study of the influence of

77 Tabellini, “Culture and Institutions,” supra 709, 711.
informal and formal institutions on economic development has direct bearing on any particular country. This is an implication of the interconnectedness of the economy and society. As one development economist observed, “what might be the single most important insight of the field of economics—that you have to be aware of the fact that everything is connected to everything else.”\(^78\) One cannot simply graft a cultural trait from elsewhere and expect the same results. Any attempt to change any set or mix of informal norms, or values, or culture, interacts in unpredictable ways with everything around it.

Let us say this could all be overcome, somehow, with incredibly sophisticated research. It still won’t be enough because we have no idea how to engineer cultural change. Granted that trust, egalitarianism, and a sense of personal control facilitates economic development or that autonomy and egalitarianism cause better governance—how does one increase these values in a society that lacks them? The Licht study asserted, “The present findings may have significant implications for development projects around the world and, in particular, for institutional reform programs.”\(^79\) That is not correct. Without knowing how to change a culture to embrace greater autonomy and egalitarianism, their study has zero implications for reform programs because it provides no guidance on what should be done to increase these values in a culture.

Contemporary scholars who study legal development came to the same conclusion—culture is key!—and same impasse. Programs aimed at erecting courts and training police are not enough to build the rule of law. “The rule of law is not something that exists ‘beyond culture’ and that can be somehow added to an existing culture by the simple expedient of creating formal structures and rewriting constitutions and statutes. In its substantive sense, the

\(^79\) Licht, et. al. “Culture Rules,” supra 682.
rule of law is a culture.\textsuperscript{80} It follows that law and development efforts should try to promote a culture of respect for the law.\textsuperscript{81} But how? Teaching children in school to respect the law—using indoctrination—won’t take hold if they witness fear or avoidance of law by others around them. Trust and respect are earned. If law works well, people will respect it; law works well when people respect it—that is the interconnectedness of society.\textsuperscript{82}

This brings us to perhaps the trickiest question of all. Any reformers who set out to change a culture in the direction suggested by the Licht study must first consider harms that might result. Cultures are webs of ideals, beliefs, and actions. Collectivist ideas enhance social solidarity, which might diminish when the level of individualism (autonomy) increases. Cherished values that might be lost when engineering culture change—assuming we knew how to accomplish it—must be considered alongside presumed gains. But this is all unknowable.

\textbf{ACCEPTING THE LIMITS OF THE KNOWABLE}

The conviction that it is just a matter of coming up with the right kinds of studies appears to propel NIE scholars forward. Elinor Ostrom’s Nobel Lecture describes decades of struggling to get a handle on “the immense diversity of situations in which humans interact.”\textsuperscript{83} She recounts exhaustively cataloging and examining rules in the hope of finding some that worked across different settings, but finally “had to give up the idea that \textit{specific} rules might be

\begin{footnotes}{
\item[82]See Tamanaha, The Primacy of Society and Failures of Law and Development,” supra.
}\end{footnotes}
associated with successful cases."84 A variety of combinations of informal and formal rules can work, Ostrom found; sometimes property regimes are successful in meeting social goals, but sometimes they are not.85 Her conclusion:

The most important lesson for public policy analysis derived from the intellectual journal I have outlined here is that humans have a more complex motivational structure and more capability to solve social dilemmas than posited in earlier rational-choice theory. Designing institutions to force (or nudge) entirely self-interested individuals to achieve better outcomes has been the major goal posited by policy analysts for governments to accomplish for much of the past half century. Extensive empirical research leads me to argue that instead, a core goal of public policy should be to facilitate the development of institutions that bring out the best in humans. We need to ask how diverse polycentric institutions help or hinder the innovativeness, learning, adapting, trustworthiness, levels of cooperation of participants, and the achievement of more effective, equitable, and sustainable outcomes at multiple scales….When the world we are trying to explain and improve, however, is not well described by a simple model, we must continue to improve our frameworks and theories so as to be able to understand complexity and not simply reject it.86

Ostrom’s essay covers a series of confounded expectations and disproved assumptions, brought down by the rich uniqueness of each social context, yet in the end she urges more research on how to build institutions that bring out the best in people. Truly appreciating social complexity would compel acceptance that what she seeks is unobtainable.

Friedrich Hayek placed great emphasis in his economic theory on “ignorance of particular facts.”87 “This structure of human activities constantly adapts itself, and functions through adapting itself, to millions of facts which in their entirety are not known to anybody.”88 Hayek directed this at socialism, showing the inadequacy of central planning, but his admonition applies fully to social scientists attempting to determine how norms, customs, mores, and

84 Id. 652.
85 Id. 656-59.
86 Id. 665.
88 Id.
traditions affect formal legal institutions and economic development. In addition to the inability to know all the relevant facts, it is impossible to take account of erroneous beliefs and the unanticipated consequences of actions.

Standing in the way of NIE objectives is not just the inability to know enough—the causal human agent within social action is the ultimate barrier. This is why social sciences have been unable to formulate universal laws of social behavior of the sort produced in natural sciences. People pursuing their objectives in socially structured contexts act on beliefs and react to changes in their action setting, which in turn potentially alters the setting in subsequent moments, and so on (multiplied across the social arena, through time). Beliefs have causal effects on behavior, even when incorrect or inadequate. Social interaction is thus dynamic, reflexive, and prone to unanticipated consequences. Only broad generalizations can be formulated about social behavior, with uncertain future application because the conditions on which these generalizations were derived are subject to change. Anthony Giddens wrote:

That there are no known universal laws in social science is not just happenstance. If it is correct to say, as I have argued, that the causal mechanisms in social scientific generalizations depend on actors’ reasons, in the context of a mesh of intended and unintended consequences of action, we can readily see why such generalizations do not have a universal form. For the content of agents’ knowledgeability, the question of how ‘situated’ it is and the validity of the propositional content of that knowledge—all these will influence the circumstances in which those generalizations hold. 89

The combined impact of Hayek’s admonition that full knowledge of relevant facts is unobtainable and Gidden’s reminder that social circumstances are constantly subject to change defeat two NIE goals: to develop a full understanding of how institutions influence one another, and to offer policy prescriptions based on this understanding.

North recognized that “long-run economic change is the cumulative consequence of innumerable short-run decisions by political and economic entrepreneurs.”90 Entrepreneurs in social arenas rely on subjective mental models of their environments and guess about the likely outcomes of prospective courses of action. “Because the models reflect ideas, ideologies, and beliefs that are, at best, only partially refined and improved by information feedback on the actual consequences of the enacted policies, the consequences of specific policies are not only uncertain but to a certain degree unpredictable.”91 The thrust of these comments apply not just to social actors, whose perceptions North was addressing in this passage, but to social scientists who propose policies to improve economic performance. A double layer of potentially erroneous models exists: those of actors themselves (making the outcomes of their actions unpredictable), and those of social scientists (making the outcomes of their policy proposals unpredictable).

A summary of what stands in their way shows the cumulative magnitude of the barrier. Measuring informal norms and culture with surveys raises serious issues of design and reliability (are they capturing the actual normative dimension at play in social life?). Correlations do not show causation or the direction of the causal arrow. General findings must be tailored to account for each unique context of application. Knowledge is non-existent on how to produce desired cultural change. Nor is there any way to know in advance and calculate the harms culture change might cause to other positive aspects of the culture. It is impossible to know or anticipate all relevant factors—including motives and potentially erroneous beliefs of actors—or the full range of reactions and associated reverberations an initiative will provoke. Unanticipated consequences inevitably arise. Everything in social intercourse is connected through threads

90 North, Institutions, Institutional Change, and Economic Performance, supra 104.
91 Id.
that reach into other dimensions of the social arena which may not be visible. And all of it is continuously moving.

Adding to these intractable hurdles is additional uncertainty owing to potential shocks to the economy and polity like natural disasters, conflict among ethnic or religious groups, unstable or aggressive neighboring countries with spill-over effects, large scale inward and outward migration, rise in energy or food prices, pollution from internal and external sources, depletion of natural resources, transformative technological discoveries, major devastating accidents (i.e. nuclear reactor meltdown), regional or global recessions, and so on.

Now consider Gerard Roland’s statement of some of the challenges for NIE:

A major empirical challenge is to disentangle the relative importance of different institutions: the quality of the legal system and of law enforcement; the quality and integrity of the bureaucracy; the nature of the political regime, electoral rules, and the degree of federalism; social capital; and social norms and values. Ideally we would be able to measure the separate effects of different institutions or the joint effect of a subset of institutions, but this task is not easy. First of all, as mentioned above, many institutions are strongly correlated….A bigger obstacle than correlation is the identification problem; institutions are usually not exogenous but may themselves be the product of other institutional constellations. Are legal arrangements causing social norms, or is it the other way around? Consideration craftsmanship and innovation in datasets will be required to find adequate estimation strategies to tackle those questions.92

If Roland means to suggest that one can determine the relative importance of different institutions in a general sense that applies everywhere, uniqueness tells us this is incorrect, so each setting differs in the constellation of influence. The juxtaposition of this task against the

---

knowledge limits mentioned above reinforces my point, though Roland holds out hope that statistical wizardry can solve it.\textsuperscript{93} That still won’t tell us how to engineer desired change.

What NIE scholars seek cannot be achieved. Detailed knowledge of how informal and formal institutions influence economic development across contexts, and the ability to produce reliable policy prescriptions therefrom, are beyond reach practically and in principle. This assertion will undoubtedly irritate some in the field as prematurely defeatist, coming after only three decades of work, with improvements in statistical analysis and computing capacity ahead. But it is not defeatist to recognize inherent limitations—just as it is not defeatist that a person who wants to get to the ground floor of a burning building as quickly as possible does not jump off the balcony because she knows she cannot fly.

Economists recently, including Avinash Dixit in his 2009 Presidential Address to the American Economic Association, have called for their research “to combine many disciplinary perspectives—economics, history, political science, sociology, psychology, anthropology, law, and evolutionary biology—and use many methodologies—cases studies and analytic narratives, statistical empirical studies, and theoretical modeling using both rational choice and behavioral approaches.”\textsuperscript{94} This is laudable, and much will be learned from interdisciplinary exchange.

When all is said and done, when all the regressions have been run, recommendations for reform produced by this cross-fertilization will look much like those Dixit already articulated in his lecture. To investors and traders in less developed countries, he recommended close attention to informal institutions and relationships and finding a local partner with established ties; to policy advisors, he cautioned that they must have a good understanding of the current

\textsuperscript{93} Roland suggests factor analysis can help. Id.
institutional equilibrium, and recommended that before they try to replace institutions they should extend a presumption that current institutions have some functional benefits; to policymakers, he advised that there are many models from which to choose, and they should make their own choice in terms of what best fits their unique situation.95 Dixit’s advice echoes the policy implications laid out by Roland at the completion of his overview. Roland counseled “skepticism” about transplanting institutions, suggesting that building on existing institutions is more likely to succeed; he encouraged gradualism, experimentation, proceeding down multiple tracks, and monitoring results; and he rejected “one-size-fits-all” approaches, instead drawing on local knowledge and engaging in dialogue among local stakeholders.96 Both of them offer sound pragmatic advice, echoed by others in development work and research.97

This is the most one can expect by way of policy recommendations. NIE scholars who hope to deliver anything more specific are on a chimerical quest: the interconnectedness of society, ignorance of particular facts, reflexive dynamism of human social behavior, and uniqueness of every situation, won’t permit more precise policy prescriptions.98 Recognizing these limits, I must emphasize, does not diminish the value of the consistently illuminating work produced in the field.

A STRIPPED DOWN VIEW OF GOVERNMENT

95 Id. 20-21.
98 An recent overview that recognizes the many complexities involved still holds to the hope that, once enough knowledge is accumulated, policy recommendations can be produced. See Eric Brousseau, Pierre Garrouste, and Emmanuel Raynaud, “Institutional Changes: Alternative Theories and Consequences for Institutional Design,” 79 J. of Econ. Behavior and Org. 2 (2011).
The foregoing analysis suggests that it is advisable to set modest objectives and focus narrowly on phenomena that bear directly on those objectives. “What are institutions?” need not be asked and leads to irresolvable puzzles. Rather than define “institutions” and “organizations” as such, one can stipulate parameters for the purposes of a given analysis. Other contexts can be examined using the same stipulations, producing cumulative information. Consistent with these lowered ambitions, I will propose a bare-bones way of framing governments and demonstrate its usefulness for certain investigations.

Most scholars think of government in terms of public functions. Roland indicates that institutions are usually classified by economists in either of two approaches. The “functional approach” defines institutions in terms of needs of contracting and investing: “we need property rights to write contracts, bankruptcy laws and courts to enforce the contracts, financial market institutions to secure investment, governments to provide public goods and infrastructure, and so forth.”99 The “macrosystemic approach” “starts from a descriptive list of different institutions, going from general (political, legal, social) to specific categories; political institutions include, for example, regime type, electoral rule, rules affecting legislative bargaining, and the degree of federalism.”100 Both approaches presuppose the government has public functions. People who occupy official positions are then analyzed in rational actor terms (by public choice theorists), as advancing their self-interest within functionally oriented government entities.

A closer look at the public-private divide raises doubts about this standard view of government. The core list of public functions usually includes policing, dispute resolution, protection of property rights and contract enforcement, law-making, governance, infrastructure

100 Id.
development, and war-making, as well as providing for the education, health, and safety of society. Yet nothing dictates that any of these activities must be supplied by government or can only be supplied by government.

In the US, for example: private security handles policing at shopping malls, gated communities, universities, corporate facilities, and public arenas; private arbitration handles a large bulk and range of disputes, from divorces to commercial conflicts; criminals are housed in privately owned and run prisons; there are private primary and secondary schools and private ambulance services; private military contractors fought in Iraq and Afghanistan, supplied and transported American troops, and provided security for American officials; roads, bridges and canals historically have been built by private companies who charged tolls. In many developing countries around the world eighty to ninety percent of disputes over matters ranging from property ownership to violence are handled outside the state legal system through informal institutions—village courts, tribal elders, or traditional tribunals—which do not apply state law but use customary norms and a shared sense of right.

Even governance is not exclusive to governments, notwithstanding the overlap in terms. The British East India Company administered large swaths of India—creating courts and enacting laws—for almost a century, earning revenues from its commercial activities as well as collecting taxes. More than two thousand company towns existed in the US in the nineteenth century near remote mining, lumber, and steel facilities; everything from stores, schools, houses, libraries, churches, roads and waste disposal systems, were constructed and owned by a single corporation, which also administered the town and established town rules. In the course of history, money has been coined by governments as well as private actors; taxes have been collected by governments as well as private actors.
As these examples show, the divide between public and private functions and entities is neither easy to draw nor fixed. Any given function can be satisfied via alternative arrangements that are functionally equivalent. The public-private divide, to put the point more abstractly, is a social construction built by ideas and beliefs of social actors. There is a separate “public” arena of certain dimensions only in so far as a collective of people believe it exists and hence bring it about.

In ground-level sociological terms, an organization can be seen as an intentionally constructed complex of coordinated actions built around positions with designated roles and attendant powers and obligations within the organization, linked by lines of communication. Roles can be specified in relation to differentiated tasks (horizontal differentiation) and in relation to layers of authority (vertical differentiation). Organizations of this type secure resources and expend resources in the course of their operations. Organizations have varying capacities to control actions by people in the organization and to exert power, in different ways, in the social arenas in which they operate. Organizations have a dual existence: individuals acting within or on behalf of the organization, and the aggregate complex of actions produced by the individual actions.

Thus far the description fits governments and corporations equally well. Governments and corporations are two among many types of organizations, though I will ignore others. These two types of organizations have strong parallels. (Municipalities in the US are literally corporations.) In contemporary times, both are constituted in legal terms; written constitutions have the same functions as articles of incorporation and corporate charters, setting out core structures and powers. And governments and corporations are explicitly created to pursue stated
purposes. Governments claim to have public purposes; for-profit corporations pursue profits; non-profit corporations advance identified causes.

The claim to provide essential public services justifies the assertion by governments of the power to tax citizens to pay for these services, and the exclusive power to make law and to exercise coercive force. It is critical to note that this is a “claim to provide essential public services.” Whether this claim is true should remain an open question. More than any other characteristic it is the open use of coercive force that distinguishes government.

The benefit of this stripped down presentation of government as an organization that secures and expend resources is that it wipes away taken-for-granted assumptions about what the government does. This is useful in development contexts in various ways, of which I will quickly mention two. For one, the public-private divide itself can be porous, commonly so when the culture does not perpetuate a strong vision of the separation; consequently, private relations and interests determine who occupies government positions and what their motivations are when exercising attendant powers. For another, legal institutions (as organizations) can have a very limited presence and reach, existing in certain social spaces but not others, hardly penetrating general social consciousness, with a marginal influence on daily social and economic intercourse; under these circumstances to carry through official legal initiatives requires sustained coercive force, and its capacity to obtain regular exaction from the populace is poor.

When both conditions hold, the government organization operates primarily as an extractive entity: absorbing resources in whatever ways it can and funneling those resources to the groups have secured control over it; public services are minimally provided. Government in
these situations is barely distinguishable from organized crime or a stationary bandit,\textsuperscript{101} although the symbolism of nationhood and international system of sovereign states help cloak this. Functional requirements necessary to social intercourse—property protection,\textsuperscript{102} assurances for agreements, responses to accidental injuries and violence—will be supplied through institutional arrangements outside government. Legal pluralism, a ubiquitous phenomenon, describes the presence of alternative legal arrangements outside the official legal system.\textsuperscript{103} This will not suffice when the economic enterprise at issue for some reason cannot work without support from official state law, but alternative institutional arrangements can otherwise be very effective.

Two points about functionalism in connection with government organizations emerge: in a given context one should ask whether claimed functions are actually being satisfied, and when they are not, one should ask whether alternative institutional arrangements are (or can) fill those needs hope.

A focused inquiry along these lines does not require one to map the entire complex of formal and informal institutions. No calls for culture change or targeting informal institutions for fixing will issue from this way of looking at things. It is about tackling a specific problem by trying to find a workable solution within the existing context, with an eye on the capabilities and tendencies of government in that locale. People in the affected arena will alter their conduct either to resist or support the arrangement, and surrounding informal norms will adjust. Then the next step must be taken, staying with what works, in a never ending process.


\textsuperscript{103}See Brian Z. Tamanaha, “Understanding Legal Pluralism: Past to Present, Local to Global,” 30 Sydney L. Rev. 375 (2008).